Chapter III Factors behind East Asian Economic Development over the Last 10 Years

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Three external factors can be cited as promoting the high growth of the East Asian economy from 1986.

(1) Appreciation of the yen-dollar rate
(2) Drop in the price of crude oil and other primary products
(3) Firm growth under low inflation in industrialized countries

The yen-dollar rate rapidly appreciated following the G5 Plaza Accord of September 1985, as shown in Figure 3. The rate, at 238 yen to one dollar prior to the Plaza Accord, reached 160 yen at the end of 1986 and 80 yen in April 1995. The high yen-dollar rate was corrected thereafter, but still held at 115 yen at the end of June 1997. The strong yen triggered an explosion of FDI by Japanese enterprises into East Asia. At the start of the yen's appreciation (1986-1988), most Japanese FDI flew into the NIEs. The destination of that FDI then shifted with time to the ASEAN4 and China.

The price of crude oil dropped in half from 27 dollars per barrel in 1985 to 14 dollars per barrel in 1986. The price of other primary goods also settled to low levels in the latter half of the 1980s. These price drops promoted industrialization in the NIEs, particularly in South Korea and Taiwan which had already fostered heavy and chemical industries dependent on massive oil consumption, but impacted hard the primary product-dependent economies of the ASEAN4, making it urgent for the ASEAN4 to begin industrialization through the active introduction of foreign capital.

As for industrialized countries, Japan overcame its inflation problem in the latter half of the 1970s, while the United States and the EU sustained only low growth through the first half of the 1980s under somewhat high inflation. In the middle of the 1980s, however, the United States and the EU also overcame their inflation. As a result, expected inflation also dropped, bringing a comparable drop in interest rates. This in turn eased the interest burden on East Asian countries and regions, excluding Hong Kong, Taiwan and Singapore, which had large foreign debts.

The easing of inflation in industrialized countries from the middle of the 1980s led to a drop in "import inflation" and a drop in inflation rates for East Asia. In the 10-year period from 1976 to 1985, the annual average inflation rates for the NIEs and ASEAN4, measured by the GDP deflator, were a high rate of 8.4 percent and 9.5 percent, respectively. In the 10-year period from 1986 to 1995, however, the annual average inflation rates dropped in half to 4.8 percent for the NIEs and 5.9 percent for the ASEAN4.

A drop in the annual average inflation rates was not observed in the case of China. Over the 8-year period for which data was available (1978-1985), the annual average inflation rates were low at 3.6 percent. This rate, however, tripled to 9.7 percent from 1986 to 1995. This tripling was due, first of all, to the fact that many prices were controlled at a low level from 1978 to 1985. From 1986 to 1995, price controls were relaxed with the introduction of market mechanism and domestic demand soared, bringing a rapid increase in prices as a result. Even including China whose inflation had worsened, the annual average inflation rate of East Asia decreased from 7.5 percent over the 1978-1985 percent to 6.1 percent over the 1986-1995 period.